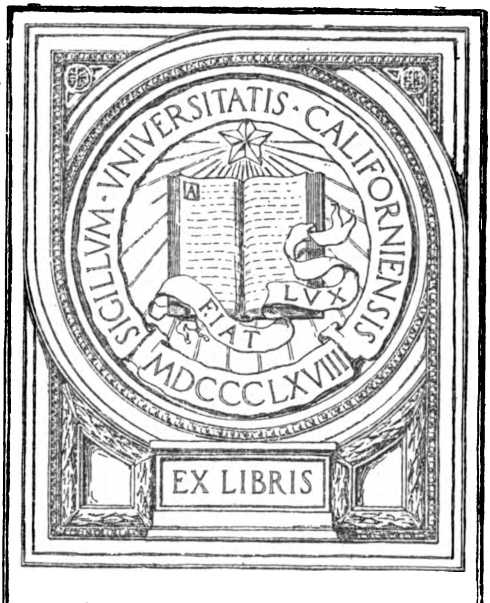
THE SCIENCE OF CURRENCY AND CENTRALIZED BANKING

By HERBERT D. MILES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AND

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A STUDY OF PUBLICATIONS RECENTLY ISSUED
BY THE NATIONAL MONETARY COMMISSION

BY

HERBERT D. MILES

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"Mr. Miles has done the work with great ability, putting in clear and readable form the gist of the great currency discussion. Few men have time to wade through the publications of the Commission, and Mr. Miles has thus done a great service to the public, and to the cause of currency and banking reform."

DAVID R. FORGAN.

THE WORLD'S BANKING SYSTEMS

IT is a truism that the science of banking, including the development of credit, is an inexact science. It must be mobile; it must grow with our growth. But there are fixed principles, laws of truth, that must always govern. When, in the crisis of 1873, our "country" banks, knowing the reserves of the banking power of the nation to be unscientifically guarded, fortified themselves at the first alarm by turning hoarders of currency, there was displayed the same old human nature which in 1907 caused them to repeat this; it was the same human nature that caused the reserve banks, in each case, to doggedly hold to what they could, having hesitated to shoulder the burden, and feeling unwarranted to resort to the pooling of their resources; it was the same human nature that filled the soul of the

business community with fear and put currency to a premium in both cases.

It is certain that this science was in its infancy, at the beginning of the last century, before the railroad and the telegraph had united distant centers of production and caused mercantile exchanges of a celerity and magnitude undreamed of. In the middle of the century its state was still a crude one; and persons may be found who think it in that condition now, in this country.

It will be helpful, before getting to an analysis of the conditions affecting the currency problem of the United States, to analyze what the world has to offer. The world, for our purposes, may properly be reduced to England, Scotland, Canada, France, and Germany.

Nothing can be plainer than that the characteristics of our people and of our opportunities, and the fact that our banking must take into account the "wants of a continent," make requisite a different application of the recog-

nized laws of banking science than is required for the peculiar conditions and surroundings of other highly civilized nations—an application of our own formulation. The situation geographically and racially nearest to ours is found in Canada, although the population there is comparatively insignificant. We shall later consider whether, while recognizing that we cannot have and do not want their system of branch banking, we cannot still learn from them, and apply, the principle that makes for the undoubted elasticity of their currency.

Let us begin with France. That country is probably the most highly specialized in banking organization and development of all highly civilized nations, and is in many ways unique. French writers upon finance are not backward in pluming themselves upon the "colossal" and "formidable" gold reserve, and the unparalleled standing of the Bank of France. They regard this as having in more than one instance since the Franco-Prussian War saved them from hostilities, due to the

respect of the enemy for their brawny "sinews." They acknowledge, at the same time, that the world's greatest accumulation of gold is, or was, in Washington; and the world's only free gold market and clearing house, in London. But a distinguished French writer upon finance, M. Maurice Patron, remarks: "The United States, owing to its precarious banking system, far from being able to derive any advantage from holding the largest gold reserve, has recently undergone a financial crisis of the severest kind; moreover, the Treasury is only a department of the Government and not a commercial institution." This is useful reading for us surely, even if hardly pleasant.

But there is much that is unparalleled in French finance besides the record of its Central Bank. It has no cotton, etc., to export, it is true, but it has an absolutely sure annual return from abroad equal to more than $200,000,000 in interest upon the equivalent of at least six "billions" of our dollars invested in foreign

securities, chiefly Government securities, and owned by its thrifty citizens. Of twelve million families there, no less than nine million own their own homes. And there were outstanding, January 1, 1908, over twelve million savings bank books—more than one to each family in France.[1] Of the amount of French Government "rentes" and other internal bonds, such as those of the Crédit Foncier, held by the small investors there, much has been written. But it will be borne in mind that the conditions are in many respects the antithesis of ours. Our people have too much development work ahead to warrant such a condition of cash savings, satisfactory and enviable as it may seem. The American small investor may have a savings bank book, and a bond perhaps, but if he hold his all in such form he is no true American, alive to his opportunities.

Let us list below the largest of the highly specialized banks in France, and later examine

[1] Alfred Neymarck, *French Savings and their Influence.*

what is worthy to be copied. In this specialization there is an interesting contrast to our own banks, which, with true enterprise, strive to comprise each in itself almost all the functions known to banking:

The Bank of France....	Government deposits; Government financing and disbursements; sole privilege of currency note issue; sole recipient of bankers' deposits; guardian of national gold reserve; discounts, rediscounts, and security loans.
Credit Lyonnais. Comptoir National d'Escompte. Société Générale.	Discounts; commercial deposits (paying interest), loans on securities.
Crédit Foncier	Sole privilege as a "land bank" making long-time loans on realty and to municipalities; operations covered by privilege of issuing long-time bonds with "lottery" feature against its loans; no deposits.

Crédit Agricole Mutual.	Agricultural loan banks—Government subsidized.
Banque de Paris et des Pays-Bas	Underwriting enterprises; no deposits.

The Crédit Foncier was authorized in 1852 to fill the need for a land credit company. Its stockholders were chiefly bankers. In 1854 a decree bestowed upon it an organization similar to that of the Bank of France, the governor and deputy governors being named by the ruler of the country. Its realty operations are chiefly on city buildings and town lots. Its "lottery" bait makes its bonds (3%) very popular.

In the same way the agricultural loan banks are encouraged and watched and subsidized by the Government. The result is a very low rate of interest to every one, even the poorest, requiring credit in France.

The centralization and specialization of the greater banks will be better understood at a glance if we record of each, in our money, that item, singly, upon which it specializes:

Jan. 1, 1909 Bank of France........	Circulation, $965,000,000; coin and bullion, $875,000,000; capital and surplus, $44,000,000.
Jan. 1, 1909 Crédit Lyonnais, Comptoir National d'Escompte. Société Générale.	Commercial deposits, $700,000,000; capital and surplus, $136,000.000.
Jan. 1, 1908 Crédit Foncier..........	Realty and commercial loans, $713,000,000.

Such figures, of course, reflect in each case an organization that includes branch banking.

This tendency to centralization has stood France in good stead, its most notable effect being the financing of the German war indemnity of 1871, when no less a sum than one billion dollars of our money (including interest paid) was skillfully raised and paid without drain of gold. We shall later discuss this in connection with the "discount system" that is used by all of the European countries that we are reviewing.

The German system is in some respects like the English and has a likeness to the French system. It is centered in the Reichsbank. There are a few important features that are an advance over the English and French systems, and there is a closer Government control, which feature probably would be satisfactory in no other leading country to-day. Senator Aldrich, in referring to German banks, has said: "These different institutions are all parts of a comprehensive system, and all depend absolutely upon the Reichsbank for reserves, and for assistance in time of trouble." The Germans were probably the first to introduce coöperative credit societies for agricultural communities, but for the purposes of our main subject of investigation these are unimportant.

As showing bank capital in Germany, the following figures, made up a few years ago, will be of interest:

	Capital paid in
17 largest German banks (including the Reischsbank)	$334,000,000
17 largest English and Scottish banks (including Bank of England)	$205,000,000
7 large French banks (none other large), (including Bank of France)	$150,000,000

The purpose of these figures was to make the French bank showing the more remarkable, but the great industrial development in Germany, and its comparative suddenness, will account for their heavy capital.

The Reichsbank has many branches. It is allowed an uncovered issue, called contingent circulation, equivalent (in 1908) to about $115,000,000. It has practically the sole right of currency issue, as with the Central Banks of France and England. In the law governing the currency issue there is an excellent feature, making for elasticity, as follows: All permanent circulation, over the allowed uncovered circulation, must be covered by full 100 per cent cash in the reserve. But it is not required that this cash be held as a special redemption fund for the notes, and it is further allowed

that for temporary purposes (elasticity of issue) the limitation of the cash reserve may be exceeded by paying to the Imperial Treasury a tax of five per cent per annum on the surplus issue, the Reichsbank maintaining at all times a reserve equal to one third of its notes in circulation, and the balance, two thirds, covered by discounted bills. A report must be published weekly and the tax imposed immediately and repeated each week as long as the excess continues. The tax is not imposed for the purpose of sending the notes home. They are frequently loaned at less interest than the tax rate.

"In five and one-half years, to July, 1906, there were thirty-seven occasions of over-issue. Such emergencies in Germany come and go before the public is aware of them."[1] A modification of the German financial legislation has been made as a result of a commission of inquiry appointed in 1908, but this has done little more than provide for increasing the

[1] Horace White, *Money and Banking,* third edition.

Reichsbank's surplus and its limit of tax-free note circulation; making the notes legal tender; and opening the way for a more general use of checks.

In both Germany and France to-day there is a marked slowness in the development of payments by bank checks between small debtors and creditors. For this reason these countries require a much greater circulating medium, and that again, as we shall see, has a heavy bearing upon their gold reserves. On the other hand, in England and Scotland the development of the bank check in settlements, practically as currency, is notable, and in some respects goes farther than in America. We shall examine this in connection with special differences in banking methods when we discuss the European discount system.

The Bank of England stands for greatness and solidity in the "financial clearing house of the world." Yet nothing has been more discussed and criticized than the hide-bound

restrictions upon the currency issues of this bank (the sole bank of issue for the nation) made by the Peel Act of 1844. This binds the bank to 100 per cent metal reserve for every note issued beyond its original uncovered currency, equal to $68,000,000, most of which was money owed the bank by the Government and against which it holds Government securities. This Act has never been changed, and has led to the deliberate and approved breaking of the restriction in times of financial crises, usually at the instance of the Government itself, which undertakes to "support a bill of indemnity in Parliament for any excess, so issued." But such a manner of meeting the situation is, of course, clumsy and slow, and only brought forward after the mischief has been done, and under great pressure. It is true that while this was done a number of times earlier in the past century, it has not been resorted to since 1866, partly due to the care with which the Bank of England's directors have conducted its business, and partly due to the great and varied

development of the use of bank checks—and, the French claim, partly to French loans.

"Money in England," declares an English writer, "is to a great extent a convention based on the assumption by the community that a credit in the Bank of England's books is as good as gold. The problem of providing emergency credit and currency, capable of easy expansion and rapid contraction, is thus solved by means of this convention, backed by the use of the check currency itself day by day."

This bank carries out vast undertakings with extraordinary ease, chiefly because of its keeping the balances of the other banks and of the Government. Thus, in the payment of interest upon the British debt, the various banks of the nation credit the holders and debit the Bank of England; the Bank of England makes credit entries upon its books to the account of these banks, and debits its holding of Government deposit—and the interest of the British debt is paid. A credit in the books of the Bank of England is regarded as so much gold,

and the prestige derived from conducting the Government banking is not the least element in that result. The other banks habitually state their "cash in hand and at the Bank of England" as one item in their balance sheets. If it is regarded as of no difference, beyond a certain point, whether a bank has actual holding of gold or legal tender, or a credit balance on the Bank of England's books, it follows that when an increase of currency is desirable it can be expanded by an increase in the credit balances of the other banks, on the books of the Central Bank; and they thus become possessed of what is regarded as more cash, to be used as a basis of credit.[1] This comes nearer to our own possibilities, and it is well to note the bearing that the bank-check system has upon it all. Of course credits of banks in the books of the Bank of France or the Reichsbank have essentially the same effect; but without the great development of the bank check England could not be the financial

[1] Hartley Withers, *The English Banking System.*

power it is on the amount of currency and gold reserve existing. M. André Liesse, giving the French point of view, states: "The check saves coin; it is the complement of the mechanism of joint-stock banks; it explains how England carries on such a large business with a very limited metallic stock. It is certainly a rational economic organization. If the Bank of England had a less *archaic*, and more flexible, machinery of issue, the system would be perfect, and crises in England would be less acute." That is plain language, but high praise of the bank-check system, which the French have not well developed. It is this lack of general use of checks that makes necessary the immense amount of bank notes issued by the Bank of France, these being required in the settlement of a great proportion of commercial transactions.

The English system seems a long way ahead of ours, and yet it is impossible not to feel that it is defective. French writers claim that the Peel Act, which, as stated, was last suspended

in 1866, would have been again suspended in 1890, at the time of the Baring failure, had it not been for the loan of 75,000,000 francs in gold which the Bank of France made to the Bank of England. The French regard themselves as the "monetary physicians of the world." This loan was made for three months, with a promise of renewal, and was secured by exchequer bonds. But the full amount was not only returned to the Bank of France with seals unbroken, but it did not even cross the channel. "It was enough that the public was conscious of such moral and material support, for the frenzy to disappear."

The Scotch were fairly civilized bankers as far back as 1727, when most of the world's banking was either absolutely simple or very chaotic. In that year the Royal Bank, receiving a charter, devised the method of "cash credits," which has been regarded as unique, and which consists of a permission extended to draw money as wanted, up to a certain sum,

no interest being charged except as the money is drawn, and the security being a personal note only, with two or more endorsers or "cautioners." This has played a large part in the development of agriculture in that country. The Scotch system is noted particularly for its branch banking. There are only twelve banks, but they have 1,065 branches, which, in a small country, means certainly no lack of banking facilities.

It is, of course, unnecessary to go into detail as to how such a system allows of even the largest credits with a minimum of gold. It is necessary to have real money only in one place. The Scottish banks have a right of note issue; being few, they stand together like a close corporation; their coin is not required to be held specially for the redemption of notes, and since the gold held against the notes is not so marked, their cash is treated as reserve against both notes and deposits. The liability of shareholders for note issues is unlimited, and the Scotch are so satisfied of the

strength of their banks that a small percentage of reserve is enough. In the final analysis, however, the Scotch banks are an appendage of the English system, and rely upon the Bank of England as their center and keeper of reserve.

The Canadian banking system is simple, and like the Scotch, its leading feature is its branch banking. There are thirty-five banks and 1,841 branches in Canada; forty-eight branches in other countries. In contrasting the situation of that country with our own, the similarity as to territory, crop movements, etc., is at once apparent, and if the branch banking feature is regarded as a prime factor in the elasticity of their currency, it must be taken into account that this, without their freedom of note issue, and redemption, would be of little account. The Canadian banker "loses nothing by locking up his circulating notes after the demand slackens, since they did not cost him anything in the first instance."

The Canadian banks are allowed to issue notes equal to the amount of paid capital without tax. But on March 1, 1908, the notes equaled $68,548,075, while the paid capital was $96,137,611. Their notes remain in circulation about thirty days, the whole circulation being redeemed twelve times each year. These notes are further protected by a bank circulation redemption fund contributed to by all the banks, equal to five per cent of the average circulation of each. This fund is in the custody of the Minister of Finance. The interest, from its investment in Dominion securities, is paid to the contributing banks. It is interesting in this connection to note that in the United States in 1909 the total National Bank circulation was only 641 millions, while the capital of these banks was 937 millions and the capital and surplus of all United States banks, National and State, over two billions.

Our lesson from this Canadian system would seem to lie in their freedom of circula-

tion and cancellation, and the common interest of all banks in avoiding the depletion of each other's reserves. And, as Horace White tritely remarks: "As they do not make runs upon each other, the public does not make runs on them. . . . Our bankers have not provided themselves with a surplus of currency for harvest time or other emergencies, because a surplus of currency is a loss to them, as soon as it ceases to be required." The redemption machinery in Canada works well, the law requiring the establishment of redemption agencies at the chief city in each of the seven provinces, and at such other places as may be directed by the Treasury. A plan of closer coöperation between our banks is a first requisite for us. We must have something to take the place of the advantages of cöoperation, derived, in Canada, from the control of many branches, these advantages covering the redemption of notes and other economic and protective features.

EUROPEAN DIFFERENCES IN CREDIT INSTRUMENTS AND DISCOUNTS

The circulation of the Bank of England is vastly less than that of the Bank of France. The reason its enormous business can be carried on with such a disproportionate amount of currency lies in the "check" which is comparatively little used in France. An interesting English development of the bank check in common use is called the "crossed check." The use of this was originally to protect the banks against fraudulent checks, but it is strikingly like the checks in use during our times of money stringency which are stamped "payable only through the clearing house." The crossed checks are furnished by some of the English banks to their customers in blank form, with these cross lines printed in, and no other form furnished. The cross marks indicate to the banks that the sum called for is not

to be paid in cash across the counter by the bank drawn on. It must be paid into a bank, by the payee, and so only becomes credited to him through the operations of the clearing house. When customers using these checks desire an exception to be made, they write upon the face "please pay cash," and sign the request. Another English restriction is found in the system of writing "not negotiable" on the face of the check. These words do not mean that the check is really not negotiable, but their legal effect is that the holder of the check cannot establish a better right to it than the party from whom he received it.[1] Thus the check passes through many hands, superseding the bank note, and the banks are protected.

But it is in the "discount system" that the most notable and far-reaching difference exists between the European and American systems. We here use chiefly the promissory note in its primitive form, in which form it is of comparatively small value to our financial

[1] Hartley Withers, *The English Banking System*.

system, insuring as it does the locking up of funds. The Europeans mobilize this, and make of it, or rather of its substitute and equivalent, the bill of exchange, an attractive short-time, bank-endorsed investment security, sought after internationally by whoever has unoccupied funds. "Bills of Exchange," says an English authority, "which are necessarily and automatically turned into cash on the day of maturity, are obviously an ideal security for a banker's investment. They are liquid and readily negotiable, and at due date they are cashed, without any need of looking for a buyer, and without any question of market conditions."

In this country the National Bank Act does not permit banks to accept time bills drawn on them. Although the Act does not specifically prohibit this, the courts have decided that national banks have no power to make them.[1] There is a "uniformity" of security in an ordinary double-endorsed and bank-accepted bill

[1] Lawrence Merton Jacobs, *Bank Acceptances.*

of exchange that can never be present in our promissory notes. So the "eyes of our financial community are fixed upon stock exchange call rates, while those of Europe are fixed upon the discount rate." It is for this reason that we hear so much of the raising or lowering of the discount rate by the Bank of England. When, for example, the rate in London is made high, foreign investors, seeking good, bank-accepted, short-term bills, purchase freely, to get the higher return, and this makes the tide of credit flow to London. The European financial system is constructed upon discounts as its foundation. A central-bank system, without it, would be shorn of its greatest power for good. Banks in Europe have their discounts so arranged that a large amount falls due daily and can thus be used to offset cash demands. In England an enormous amount of bills is held by special discount companies and bill brokers, while in France and Germany the banks have less hesi-

tation in rediscounting freely with the Central Bank, thus eliminating the bill broker.[1]

When the preliminaries of peace were signed at Versailles in February, 1871, it was stipulated that France should pay Germany a war indemnity of five billion francs, the final payment of three billion, with interest, to be paid by March 2, 1874. By the purchase of letters of exchange the Bank of France, acting for the Government, not only shouldered this staggering task without draining itself of gold, but made the last payment six months before the limit of time set. The money was raised by two very successful Government bond issues. This credit was used by the bank to purchase all kinds of bills of exchange, English, Dutch, etc., and these had to be converted into German funds. This was simply accomplished; the operation was conducted with skill and good judgment; and it remains a monument to the value of the discount system, as well as to the courage of the Bank of France.

[1] Paul M. Warburg, *The Discount System in Europe*.

The ordinary bill of exchange, known as a "prime banker's bill," is a draft drawn upon a bank, under agreement, by the seller or manufacturer or grower of merchandise. This draft is for the amount of the actual or the expected sale, as the case may be, and calls for payment at a future date, usually one to four months, when the debt for the goods shall fall due, or the produce be harvested and sold. The banker, on receipt of this, as previously agreed, writes "accepted" across the face of the draft and signs it. This means that the bank undertakes to certify that the draft will be paid at maturity. The draft has usually two endorsements, which with the added bank endorsement makes it a liquid asset, salable by discount to another bank or to an investor. It is regarded as nearly as certain of redemption as a note of the Bank of England, or the Bank of France, and as an investment it commands a broad market.

The American banker, on the other hand, as a rule locks up his promissory note, and so

invests his call obligations (his deposits) in a time loan. There are also bills drawn by the seller directly upon the buyer; these are not freely handled as liquid funds. Then there is, of course, the finance bill, drawn against collateral, all a part of the system.

In an international way, also, our commerce suffers through our lacking this system. The English importer, for example, arranges with his bank for its acceptance of a sixty- or ninety-day sight bill drawn upon it by his foreign shipper. The shipper draws his bill, attaches his invoice, bill of lading, etc., and sells the draft to his banker, who is usually glad of funds on London. The shipper is content, having his cash, less the discount. When the documents reach the London bank the draft is endorsed "accepted," as arranged, and the shipping documents turned over to the importer. The accepted draft is now a bill of exchange, and is sold by the London agent of the bank of the foreign shipper. That bank's funds are thus restored by its London credit.

Our importers, on the other hand, not being permitted under the law to arrange for time drafts on banks here, are unable to finance their purchases upon as favorable a basis, and are at a disadvantage that is sometimes serious.

It would appear, then, that we suffer a heavy economic loss in many ways, both as to domestic and international commerce, through our primitive manner of handling commercial paper; and it is far from impossible for us to correct it.

GOLD RESERVES, CRISES, AND AMERICAN METHODS

In April, 1893, the gold reserve of the United States Government—a Government that prides itself upon not being paternal in the sense that some governments are, and whose reserve, therefore, under its system, is of little value to banking, commerce, and credit outside the guarantee of its own notes—fell below one hundred million dollars. A serious crisis resulted. This was due (1) to a lowered revenue out of a lowered tariff; (2) to the issue of $156,000,000 in legal tender notes between 1890 and 1893, the redemption of which in gold was very problematical, causing the drain of about that quantity of gold, under the principle of Gresham's Law; (3) to a sudden drop in the value of silver (from eighty-two cents to sixty-seven cents per ounce), due largely to the closing of the mints of India to silver. Ten

years later, on October 1, 1903, the United States Treasury held no less than six hundred and fifty million dollars in gold,—the largest stock in the world.

The Bank of England, undertaking the finances and disbursements of the British Government, in the acknowledged center of the financial world and in the only free gold market of the world, shows on hand in 1903, and again in 1910, an amount equal to only about $160,000,000 in gold in each case; it is fair to assume it had no more in 1893. For light upon the theory of gold reserves in general, let us quote from M. Maurice Patron, representative of the country distinguished for its holding of the greatest permanent reserve: "A sufficient reserve of good money is the sign of a flourishing state. Superabundance of metal discloses the plethora of a sanguine temperament, subject to crises. The monetary congestion of Germany after the [Franco-Prussian] war, and the payment of the indemnity [one billion dollars] offers a sufficient example. A

monetary bloodletting in a healthy and prosperous state may stimulate activity." And again: "It is needless from a general standpoint to attach much importance to the abundance or scarcity of gold. It is only essential that its world-wide distribution be constantly assured in close correspondence with the needs of the given country and the supply of the neighboring state."

In the matter of automatic supply, M. Patron's views are interesting: "A country can never succeed in building up gold reserves by artificial means; first of all, it must create the need of gold, and then the international market will of itself undertake to supply its need. It is thus that owing to our [the French] *late development of the system of checks and transfer, we have created a considerable need of gold* [the italics are mine], which the international market has had to supply. Each market possesses the amount of gold which it should have —no more, no less. This international distribution is effected by the very nature of things,

with perfect precision. . . . The factor which must be reckoned with is independent of the speculator, and any operation which would neglect it would lack support and prove to be a dangerous error."

Thus it is not necessarily the country having the largest gold reserve that must lead; considering its shareholder's interest only, it could matter little if the Bank of France had but a third of its present gold reserve, equal to about $600,000,000; and if a third, it would still be slightly larger than that held by the Reichsbank or the Bank of England. But the Bank of France has other considerations: (1) a lack of bank-check development; (2) an exposed condition as to possible wars; (3) the claim that owing to their wealth of gold they need not fear the greater progress in commerce and industry in certain surrounding countries; (4) the enjoyment of the lowest and most stable money rates in the world.

It is pointed out by M. Patron that the maintenance of a country's gold reserve, while a

public function, cannot be performed by the state itself (as has been amply proved at times in our country), and it is naively added: "In the United States, it is true, this burden falls upon the Treasury, but it is unnecessary to lay stress on the fact that at the present time the American financial system does not deserve to be taken as a model."

The avoidance of Crises is largely the art of safeguarding reserves while freely extending credit—and fearlessly and quickly applying "aid to the wounded"—to the source of the infection. If we could have done that it would have been most effective, I think, in all of our crises since the middle of the last century, except that of 1893, which was due more to our Treasury system, coupled with certain governmental and legislative errors or blunders. It was in such a skillful way that the Bank of France came to the relief when the great Union Générale, which had enjoyed the highest standing and credit, suddenly went under,

just before the International Exposition was to open. The action of the Bank of France in this case has been briefly described as follows: "It contributed greatly to the restoration of confidence; it came to the rescue of other institutions that were compromised, by rediscounting a part of their commercial paper; it helped individuals by receiving the sums they had withdrawn in fright; and it brought general relief by making the discount rate 3½ per cent. . . . And the good done did not stop here, as the prosperity of the better managed banks dates from this period."

Later, in another threatened crisis, when the old Comptoir was about to go to pieces through rash operations in loaning to a copper syndicate, the Bank of France loaned this institution equal to $26,000,000 upon its commercial paper and securities. This loan was made directly after one half that amount had been drawn out by depositors of the Comptoir in only two days. It was made in bank notes, without drawing upon the reserves, the bank's

issue standing well under the maximum allowed by law. It then assisted in the liquidation, which was concluded without loss, even to keeping the capital stock nearly intact.

Let us suppose that all this, including the relief given by a 3½ per cent discount rate, had not been sufficient, and that there came a drain of gold from abroad: the Bank of France would then have taken the opposite tack on discounts. The reason for this we have explained. "When money has acquired a considerable value in the country where the crisis exists, foreign capital will not fail to flow in," —under the discount system. With us, it flows in only *after* a panic, in order to pick up bargains in stocks.

France, however, seldom has had to resort to the sharp raising of the discount rate; England frequently does. The objection to it lies in the fact that commerce has to bear the brunt of the remedy, while the bank's earnings actually increase. It means contracted credit and a check to industry.

How has this country, without a Central Bank of Issue, with a Government Treasury next to useless for the purpose of affording the basis of commercial credit, and without the European discount system, handled its crises? Several large books have been written for the express purpose of answering this question, but perhaps, as we are proud, the quicker and more briefly it is answered, the better. And here it will be well to observe that nothing in the system of such a Central Bank of Issue as exists in European countries can be construed as putting a premium upon over-speculation, or as an incentive to bankers of a speculative type to operate upon a theory that they would be taken care of, in the event of their sins re-acting upon them. *It is the situation, not the individual, that is taken care of.*

In our crisis of 1873 a bright point, well worthy of our attention, is found in a certain courageous action upon the part of the New York Clearing House. That is the more notable in that it has not been repeated in later

crises. Their resolutions declared for clearing-house loan certificates, and then added as follows: "The legal tender belonging to the associated banks shall be considered and treated as a common fund, held for mutual aid and protection." It is true that in the light of peaceful days many objections can be found to this action, or to the right of a bank to enter into it, but this was a "war measure." It diminished the likelihood of the banks working at cross purposes. It was effective. But unfortunately for its best result, it was taken two days late. The value of celerity in such matters is immeasurably great. The opinion has been expressed by a high authority, Dunbar, that the delay of two days in this action involved serious consequences which might have been averted. The impending failure of Jay Cooke & Co. was known on Wednesday; this action might have been taken Thursday, but it was not until Saturday that it came to the rescue of a situation badly demoralized. Runs upon particular banks ceased, as the reserves of

all the banks were at the disposal of any threatened bank. But the lateness of the action and consequent troubles prevented the extension of confidence to the country banks having deposits in New York,— with the usual result.

It is interesting, as having a direct bearing upon the problems we are even now called upon to solve, to note the following terse and pithy comment included in the report of the Committee of the New York Clearing House in 1873, appointed to report upon reforms required: "Much impatience is expressed at the law which compels banks to hold a definite ratio of legal tender notes to liabilities. The practical difficulty consists in attaching a rigid and inflexible rule of law to a mobile fund which is held for the purpose of meeting sudden contingencies. . . . There seems an intrinsic absurdity in a law requiring that a reserve must be always *kept*, which was created *on purpose to be used*."

In the crises of 1893 and 1907 the banks of our country followed a policy which, while no

doubt regarded as having been forced upon them, hardly bears, on the face of it, a creditable comparison with the action of 1873 in New York. A good reason for this, if not a new one, is found in the testimony of Mr. Alexander Gilbert before the House Committee on Banking and Currency, April 13, 1908. A great deal might be said in more detailed explanation of the embarrassment to the banks of the reserve cities, due to the system existing which requires each country bank, in case of alarm, to act independently upon the crude and uncivilized principle known as "every man for himself, and the devil take the hindmost." But business men, bankers, and legislators will hardly require more than Mr. Gilbert's testimony, as follows:

> "By far the largest cause of currency hoarding is in the fact that the banks throughout the country proceed to fortify themselves. There are sixty-six hundred national banks, all, or most of them, outside of New York, hoarding centers, dominated

by an idea of self-preservation; each seeking to fortify its own reserves. And why is this? Simply because there is no central agency of relief to which they can apply for help in time of trouble. Every banker feels that he must stand alone."

Based upon conditions here reviewed, conclusions reached by readers will, of course, vary to a certain extent, dependent upon their personal points of view and their experience. But it is fair to say that we will hope for, and expect, upon the part of the National Monetary Commission and Congress, action which shall satisfactorily cover this country's conditions as they exist, and that, too, without providing either too much hampering of law or the revolutionizing of existing forms of interdependence between banks of the reserve cities and country banks.

It is also fair to say that the present national usury laws, which operate to prevent absolutely the inflow of money internationally for

the purchase of our commercial paper in times of crises, can be repealed or suitably changed. Discount, at a rate tempting to the international investor, is better than no discount at all. And, too, our law which restrains banks from the acceptance of time drafts can surely be repealed or changed. With this done, we would undoubtedly find it possible to make our commercial paper an international, rather than a strictly local or national, investment. Money would then flow to us, as to other nations in times of need, in payment for our paper, in place of being held back until the worst exists, and restricted then to panic bargains in stocks.

And we can no doubt agree that our present law requiring a fixed and immobile reserve can be changed. Ours is the only country which requires a fixed percentage of reserve, and there is on record the whole world's experience as well as that of our own state banks in evidence that it is illogical and unnecessary.

It is significant that the Central Bank is the

heart without which the most enlightened European national banking systems could not exist, but whatever our solution of the conditions facing us in the United States, it is surely not too much to expect that wise action, such as we confidently look for, will create a situation so liberal, unhampered, and yet guarded, that it shall result in all of the banks of the country eventually preferring to operate as "national" banks—under the same laws, under one system of inspection, and one in their interests covering currency issue and redemption. The old condition of divided strength and even of self-centered isolation, in times of crises, would then be done away with forever.

Let us expect then a consummation that shall assure us an even flow of currency as required, with perfect ease of redemption and cancellation; an even control and reasonable basis of money rates; a stability and resourcefulness in crises; and a use of our natural wealth and unparalleled resources that will bring into being the inevitable American leadership in world finance.